

General Information Letter: An employee stock ownership plan exempt from federal income taxation under IRC Section 501(a) is subject to Illinois income tax only if it has unrelated business taxable income.

June 10, 1999

Dear:

This is in response to a letter from xxxxxxxxxxxx on behalf of your firm dated April 20, 1999, in which she requests information on the tax status in Illinois of a client of your firm, namely an Employee Stock Ownership Plan ("ESOP"). The nature of the letter and the information provided requires that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In xxxxxxxxxxxx letter, she stated the following:

"We are seeking information regarding the tax status of our client, an ESOP, which is the owner of 100% of the stock of an S-Corporation required to file in your state.

"The situation is as follows: The ESOP owns 100% of the S-Corporation stock. The S-Corporation is a multi-state business which files in your state. Internal Revenue Code section 512(e)(3) exempts ESOP's from unrelated business income tax. Therefore, the ESOP will not be paying any federal income tax on the S-Corporation earnings passing through to it.

"We would like the following information regarding the status of the ESOP in your state:

1. Is the ESOP also exempt in your state? Please site the applicable regulation or statute.
2. What forms, if any, will the ESOP be required to file with your state?"

### **Response**

The Illinois Income Tax Act (35 ILCS 5/101 *et seq.*; the "IITA") imposes a tax measured by net income on every individual, corporation, trust and estate on the privilege of earning or receiving income in or as a resident of the state of Illinois. See IITA §201(a). Additionally, a Personal Property Tax Replacement Income Tax measured by net income is imposed on every corporation, partnership and trust. See IITA §201(c). In arriving at net income allocable to Illinois, a taxpayer's base income must first be determined. See IITA §202.

For an organization exempt from federal income tax under IRC §501(a), its base income shall be its unrelated business taxable income as determined federally under IRC § 512. According to IRC §4975(e)(7), an ESOP is a qualified stock bonus plan under IRC §401(a). In turn, an organization qualified under IRC §401(a) is exempt from federal income tax under IRC § 501(a). Thus, an ESOP would have as its base income its unrelated business taxable income in determining Illinois income tax liability. Where, *and to the extent*, an ESOP's earnings passed through to it as a shareholder of a Subchapter S-corporation do

IT 99-0061-GIL

June 10, 1999

Page 2

not constitute unrelated business taxable income under IRC §512, such earnings will not be subject to Illinois income tax or replacement tax liability under IITA § 201.

However, if an ESOP has taxable income other than exempt S-Corporation earnings and reportable as unrelated business taxable income under IRC § 512, then the ESOP may be required to file Form IL-990-T. An ESOP with unrelated business taxable income must file a Form IL-990-T if it has net income as defined under the IITA, or it is a resident or qualified to do business in Illinois. Copies of Form IL-990-T with instructions and IITA §1501(a)(20) definition of "resident" are enclosed herewith for your convenience and use in determining your client's Illinois tax obligations.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If your client is not under audit and you wish to obtain a binding Private Letter Ruling regarding its factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Sincerely,

Jackson E. Donley  
Senior Counsel-- Income Tax